SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1186

MODERN FACTORS COMPANY,

Petitioner,

vs.

TASTYEAST, INC.

RIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

Opinion Below.

The opinion of the United States Circuit Court of ppeals for the Third Circuit was rendered March 19, 1942, nd is reported in — F. (2d) — .

II.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 0-A of United States Judicial Code as amended by Act February 13, 1925, 28 U. S. C. A. Sec. 347-A.

III.

Statement of Case.

The essential facts in the instant case are fully set forth in the accompanying petition for Writ of Certiorari, and for the sake of brevity are omitted here. All necessary elaboration of the points involved will be made in the Argument which follows.

IV.

Constitutional Provisions, Federal Statutes and General Law Involved.

A statement of the pertinent portions of the Constitution of the United States, the Bankruptcy Act, and the principles of general law involved, will be found in Appendix "A" hereto annexed and made a part hereof.

V.

Specification of Errors.

The questions presented for determination are set forth in Appendix "B" hereto annexed and made a part hereof.

We submit that the legally correct answers to these questions call for a determination by this Court that the decision of the Circuit Court of Appeals below was erroneous. It will be urged that it was error for the Circuit Court of Appeals below to determine these questions adversely to the petitioner.

VI.

ARGUMENT.

Point 1.

The decision of the Circuit Court of Appeals in the instant case is in direct conflict with, and contrary to, the decisions of this Court and other Circuit Courts of Appeal, and deprives petitioner of its property and rights to property without due process of law.

Petitioner throughout the proceedings in the court of original jurisdiction, and in the Circuit Court of Appeals, insisted that inasmuch as it was the only secured creditor of its class, there was no authority for the confirmation of any plan of reorganization which authorized the debtor to pay this secured creditor less than the full amount of the debt, with interest, as agreed, while retaining to its own use a portion of the property securing the debt. To do so does violence to the substantive property rights of petitioner, and is inconsistent with the Fifth and Fourteenth Amendments to the Constitution of the United States. This Court laid down the principles applicable to the facts in the instant case in *Re Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 79 L. Ed. 1593; *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island and P. Ry. Co.*, 294 U. S. 648; and, *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1.

The Circuit Court of Appeals for the 9th Circuit, in *Re Security-First National Bank* v. *Rindge Land & Navigation Co.*, 85 F. (2d) 557, at p. 561 (C. C. A. 9th), in reversing an order and decree confirming a plan of reorganization, said:

> "There is nothing in section 77B which authorizes a debtor to pay a secured creditor less than half the amount of the debt while retaining to its own use a por-

> tion of the property securing the debt. The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution. Louisville Joint Stock Land Bank *v.* Radford, 295 U. S. 555, 594, 28 Am. B. R. (N. S.) 397, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106."

In *Re 333 No. Michigan Ave. Bldg. Corp.*, 84 F. (2d) 936, the Circuit Court of Appeals for the 7th Circuit dealt with a situation similar to the instant case. The debtor there had a class of creditors consisting of only one party, and the court held at p. 940:

> "Under Section 77B, the rights of all claimants and creditors are entitled to the same protection, but they may be divided into classes, as was done in this proceeding. That law requires a two-thirds vote of each class before a plan can be confirmed, and that provision was complied with in the case before us. *When a class consists of only one party, regardless of the nature of his claim, his consent must be obtained, provided his claim is affected by the plan.* (Citing) Continental Illinois Nat. Bank & Trust Co. *v.* Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 1110; Louisville Joint Stock Land Bank *v.* Radford, 295 U. S. 555, 28 Am. B. R. (N. S.) 397, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106; Cumberland Glass Manufacturing Co. *v.* DeWitt, 237 U. S. 447, 34 Am. B. R. 723, 35 S. Ct. 636, 59 L. Ed. 1043."

It is to be noted that the Circuit Courts of Appeal in the two cases from which the foregoing excerpts appear, regarded the *Louisville Joint Stock Land Bank* v. *Radford* case, *supra*, as controlling, and the final judicial word on the subject.

The United States Circuit Court of Appeals for the Third Circuit, nevertheless, disregarded these binding principles

of law, resulting in an invasion of petitioner's rights thereunder. These principles are supported by *Case* v. *Los Angeles Lumber Products Co., supra.*

In re Herweg, 119 F. (2d) 941, (C. C. A. 7th), the court, in following *Louisville Joint Stock Land Bank* v. *Radford, supra,* and *Case* v. *Los Angeles Lumber Products Co., supra,* passed upon a real property arrangement under Chapter XII. It applied the principles established in *Louisville Joint Stock Land Bank* v. *Radford,* stating that many of the observations of Mr. Justice Brandeis were peculiarly applicable, and said:

> "We therefore hold that section 461 (11) does not authorize the court to force secured creditors unanimously opposed to the plan, to accept payment of a reduced amount of their claims and leave the debtor in possession of the property formerly securing those claims entirely free from their burden • • •"
>
> " 'This right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage' • • •".
>
> " 'In no case of composition is a secured claim affected except when the holder is a member of a class; *and then only when the composition is desired by the requisite majority and is approved by the court'.*"

In the case of *Chapman* v. *Security &c. Bank* (C. C. A. 7th), 111 F. (2d) 86, at p. 87, the court, in referring to *Los Angeles Lumber Co.,* case, *supra,* said:

> "The case last cited is directly applicable to the facts of this case, *for it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act,* Sec. 77B, sub. (f) 11 U. S. C. A. Sec. 207, sub. (f)."

It is respectfully submitted that the authorities cited in support of this point manifestly demonstrate the error into

which the Circuit Court of Appeals below fell, in its determination.

POINT 2.

The Circuit Court of Appeals in denying petitioner agreed interest on its secured claim to the date of payment, ruled contrary to the established principles of law laid down by this Court that a creditor holding a secured claim is entitled to interest to the date of payment.

The attention of the court below was called to the opinion in the case of *In re Deep Rock Oil Corp.*, 113 F. (2d) 266, at p. 269, (C. C. A. 10th Cir.), which involved an appeal from an order denying a claimant the right to participate in a reorganization plan, it being contended in the course of the controversy that the court below had erred in allowing interest to the note holders and preferred stock holders of the debtor corporation. The inference is clear that the interest there allowed was at the rate provided for in the notes and in the preferred stock. The court held:

> "*A creditor holding a prior lien is entitled to interest to the date of the payment out of the proceeds derived from the property covered by such lien.* Spring Coal Co. *v.* Keech (C. C. A. 4th Cir.), 239 Fed. 48 L. R. A. (1917D) 1152; Central Trust Co. *v.* Condon (C. C. A. 6th Cir.), 67 Fed. 84; McFarland *v.* Hurley (C. C. A. 5th Cir.), 286 Fed. 365; Board of Com'rs of Sweet Water County, Wyo. *v.* Bernardin (C. C. A. 10th Cir.), 74 F. (2d) 809. * * *"

The case of *American Iron & Steel Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, was also cited by the court in *Re Deep Rock Oil Corp., supra.* It involved the right of recovery of interest on a claim against a railway company during the period of a receivership. This Court answered the question in the affirmative in a most illuminating opinion by Mr. Justice Lamar, who, in discussing the treatment to be accorded to the various classes of creditors, considered them

on the basis of whether they were of equal dignity. After restating the well-known rule that on ordinary debts interest terminates at the date of adjudication in bankruptcy, Lamar, J., said (at p. 267):

> "The principle is not limited to cases of technical bankruptcy, where the assets ultimately prove sufficient to pay all debts in full, but principal as well as interest accruing during a receivership, is paid on debts of the highest dignity, even though what remains is not sufficient to pay claims of a lower rank in full. Central Trust Co. *v.* Condon, 14 C. C. A. 314, 31 U. S. App. 387, 67 Fed. 84; Richmond & I. Constr. Co. *v.* Richmond, N. I. & B. R. Co., 34 L. R. A. 625, 15 C. C. A. 289, 31 U. S. App. 704, 68 Fed. 116; First Nat. Bank *v.* Ewing, 43 C. C. A. 150, 103 Fed. 190."

continuing further:

> "* * * *For, manifestly the law does not contemplate that either the debtor or the trustees can, by securing the appointment of a receiver, stop the running of interest on claims of the highest dignity.*"

The District Court in the case at bar stated (Appendix below, p. 7), in confirming the Referee who found for petitioner, that the case of *International Raw Material Corp.*, 22 F. (2d) 923 (C. C. A. 2nd Cir.), was judicial guidance to his court. That case involved an appeal from an order directing a factor to pay over to a trustee certain moneys retained by it to cover attorneys' fees, commissions, and interest charges, secured by a lien asserted by the factor against accounts receivable assigned to it by the bankrupt. The court stated the question in the following manner:

> "(1) Can an agreement by a corporation to pay a rate of interest or a commission in excess of the legal rate be held invalid by a court of bankruptcy, having the custody of a fund which is collateral security for the performance of the agreement, upon the ground that a

lien upon that fund for an excessive rate is unconscionable and should not be sanctioned by a court of equity?"

By way of answer, it said:

> "* * * In Boise v. Talcott (C. C. A. 2nd Cir.), 45 Am. B. R. 117, 264 F. 61, this court allowed interest charges of 6 per cent, plus commissions of 10 per cent for acting as selling agents, together with a discount of 10 per cent on each loan to the bankrupt. *There seems no justification in nullifying the agreement of the parties here, because the interest and commissions which they deliberately arranged were too large to satisfy the idea of a court. Here, as in other similar cases, the competition of the market fixes rates. The statute has not attempted to control usury contracts made by corporations. Any decision by a court as to what would be a reasonable rate would either have to vary with the kind of security furnished or else be a mere doctrinaire pronouncement. Corporate contracts to pay more than the statutory rate of interest have been, and we believe should be, left to the agreement of the parties, and not disturbed, in the absence of fraud or duress.*"

Circuit Court Judge Augustus N. Hand, who wrote the opinion in *Re International Raw Material Corp., supra*, also wrote the opinion in *Re Gotham Can Company*, 48 F. (2d) 540, in which case the question of the right of a secured creditor to accrued interest up to the date of payment, was under consideration. There an agreement had been made between a bankrupt and a finance company whereby the latter advanced money to the bankrupt upon the security of accounts receivable, and the bankrupt was to pay 1/30 of 1 per cent of the face value of such accounts for each day from the date of purchase. The District Court disallowed charges accruing after adjudication. Upon appeal, this order was modified by the Circuit Court of Appeals holding

that the rights of the parties are governed by the contract. The court interpreted *Sexton* v. *Dreyfus,* 219 U. S. 339, 31 S. Ct. 256, 55 L. Ed. 244 and said at p. 542:

> "The Supreme Court, following the English decisions, accordingly held that a creditor in such circumstances must first apply his security to the liquidation of the debt, with interest to the date of the petition. *It was never suggested that he could not pay interest accruing up to the very date of payment out of the proceeds of the collateral if he might thus satisfy his entire claim. That he may do this has frequently been held, and any other result would be contrary to section 67d of the Bankruptcy Act.*" (Citing numerous cases.)

POINT 3.

Under the applicable decisions of the Courts of New Jersey, the agreement for the rate of the interest provided for in the mortgage was not an agreement for a penalty. In failing to follow these decisions the Circuit Court of Appeals below erred.

The mortgage debt was found valid and free from fraud and duress. (See Referee's Opinion, Appendix "C" hereto.)

In the case of *Ramsey* v. *Morrison,* 39 N. J. L. 591, *which reflects the general law in New Jersey,* the Supreme Court of New Jersey succinctly stated the facts before it and the law applicable thereto, as follows:

> "The contract between these parties, as shown by the note and the agreement, was, that the defendant, in consideration of the loan of $250, made to him at the time, would, in one month from the date of the loan, pay the same back to the plaintiff, with lawful interest; and that if he failed to make such payment, according to the terms of the contract, that the twenty-five shares of stock placed in the hands of the defendant, by way of collateral security, should be forfeited to the plaintiff.

> This provision of forfeiture was by way of penalty for the non-performance of the contract. The contract itself called for no more than the payment of the sum loaned, with legal interest upon it, and the borrower had the right to pay to the plaintiff the principal and interest, according to the terms of his contract, and thereby avoid the penalty. It is essential to the nature of usury that a certain gain, exceeding the legal rate of interest, is to accrue to the lender as a consideration for the loan. *If the gain to the lender, beyond the legal rate of interest, is, by the contract, made dependent on the will of the borrower, as where he may discharge himself from it by the punctual payment of the principal, the contract is not usurious.* Pomeroy *v.* Ainsworth, 22 Barb. 120; 2 Parsons on Notes and Bills 413, cases cited in note y; Cutler *v.* How, 8 Mass. 257; Parsons on Con. (5th ed.) 116, and notes; Roberts *v.* Trenayne, Cro. Jac. 509."
>
> "This case comes clearly within the principle stated. The contract is not usurious. This being the only point raised, the plaintiff is entitled to judgment upon the report, and the rule is discharged."

The Circuit Court of Appeals, on page 5 of its opinion (R. 21), gootnote 24, conceded that the *Ramsey* case is the only one in New Jersey on the proposition that an agreement such as is involved herein is not usurious in New Jersey, because the debtor could discharge itself from the obligations thereunder by punctual payment of the principal, finding that the agreement did not exceed the highest applicable rate prescribed by law.

The opinion of the Supreme Court of New Jersey is in accord with the principles of law established by this Court *in re Lloyd* v. *Scott,* 4 Pet. 205, 7 L. Ed. 833, and, the same rule prevails in the States of Arkansas, Idaho, Iowa, Illinois, Maine, Massachusetts, Minnesota, Nebraska, New Jersey, Oregon, Virginia, Wisconsin, and in England.

The Circuit Court of Appeals below was in duty bound

to follow and accept as the law applicable here, the principles laid down in *Ramsey* v. *Morrison,* and *Lloyd* v. *Scott, supra.* In failing to do so, the court erred. *Fidelity Union Trust Co.* v. *Field,* 311 U. S. 169, 85 L. Ed. 109.

In re Downey v. *Beach,* 78 Ill. 53, cited in American and English Annotated Cases, Vol. 7 p. 490, the court, in passing upon a comparable situation where no fraud was practiced by a lender to procure a note with a provision for payment of 30% after maturity, said:

> "If he has suffered injury that may now seem grievous, it is attributable alone to his (the maker's) own laches. It is his own contract which is valid at law, and a court of equity will not interfere to set it aside."

We submit that the contract, being enforcible, and one not calling for a penalty under applicable New Jersey decisions, the court could not equitably set the same aside in whole or in part.

The case relied upon by the Circuit Court of Appeals below, to wit, *Kothe* v. *Taylor,* 280 U. S. 224, 226 is not applicable, and an examination of that case clearly demonstrates the force of our argument. In that case the theory underlying the decision was that the parties to the contract were consciously undertaking to contract for payment to be made out of the assets of a bankrupt estate at the expense of the creditors, and not for something which the bankrupt lessee there personally would be required to discharge. There was no reasonable relationship between the obligation undertaken and the effect upon a breach thereof. In the case at bar, the creditors are not affected by the contract, but only the debtor, and it is the debtor who seeks to obtain the benefit of its own contract, resorting to reorganization under Chapter

X to accomplish what it could not otherwise achieve. The rate of interest agreed to be paid after default was reasonably comparable to the rate actually paid prior thereto. It is therefore, respectfully contended that the cases are neither analogous nor comparable, and the principles of law laid down in *Kothe* v. *Taylor, supra,* are wholly inapplicable.

POINT 4

The Circuit Court below in rendering its decision has decided an important question of general law in a way untenable and in conflict with the great weight of authority.

The principles of general law applicable to the facts in the case at bar are stated in 82 A. L. R. 1214, and have heretofore been otherwise referred to and argued under the preceding point with convincing and appropriate citation of authorities.

The obvious object and avowed intent of the debtor, and the new corporation which succeeded it under the plan of reorganization, was to obtain the benefits of accrued interest belonging to petitioner under the terms of the contract. This resulted in stripping the mortgagee of his contract rights, and constituted confiscation without legal warrant. It was an attempt to rewrite the contract without legal justification. See *Fox* v. *Cronan,* 47 N. J. L. 493, cited with approval by the Supreme Court of New Jersey, in *Smith* v. *Koenig,* 57 N. J. L. 486, and *Finkel* v. *Lepkin,* 62 N. J. L. 580.

The Circuit Court of Appeals below failed to apply these accepted principles of law as they were applicable here, and so far departed therefrom as to call for an exercise of this Court's power of supervision. *Fidelity Union Trust Co.* v. *Field, supra.*

Conclusion.

It is respectfully submitted, therefore, that in order that the errors herein pointed out may be corrected and justice done; and the law properly and authoritatively defined; that the judgment of the United States Circuit Court of Appeals for the Third Circuit should be reviewed and reversed, and, to such an end a Writ of Certiorari should be granted.

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